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No. 677

In the Supreme Court of the United States

OCTOBER TERM, 1966

THE A. P. SMITH MANUFACTURING COMPANY,
PETITIONER,

v.

THE UNITED STATES

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

PETITIONER'S REPLY BRIEF

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None of the arguments presented in the Government's brief in opposition is relevant to the question presented.

The question presented is whether, as held below, there should exist a rule of law that an employer's annual contribution to its self-administered fixed benefit pension plan constitutes a final purchase by the employer of the plan advantages thought to accrue to the employer in the year of contribution, so that where, as here, the contribution is made in appreciated property, the appreciation is thereby realized as taxable gain of the year of contribution. Ought there to be a rule of law so strong that the courts must brush aside an undisputed record of fact* showing that the ad-

*In the case at bar the Commissioner admitted petitioner's evidence (R. 337, R. 137-232) but refused (R. 338) to make findings (R. 73-127) thereon.

vantages of such a plan flow toward the employer not in consideration of its annual contributions or the lack of them, but because of the employees' continuing expectation that on retirement they will be paid life annuities in accordance with the plan formula, the cost of which cannot be known or accurately estimated in the year of contribution? Ought there to be a rule so strong that courts must hold that where, as here, the contributed property remains unsold or partly unsold at the close of the taxable year, gain is to be deemed realized although a further unknown obtains as to the extent to which the contributed property will, when sold, provide dollars toward meeting future pension costs? Can this so strong position be maintained without the prop of a statute limiting employer deductions for pension plan contributions to deferred compensation for services actually rendered, a limitation which Congress has expressly refused to impose (pet. 14-16)?

1. The Government argues (br. 2) that "the stock was transferred in payment of an ordinary and necessary business expense." Of course if the stock had been transferred in full satisfaction of the cost of a desired business advantage, the appreciation would have been realized thereby. *International Freighting Corp.* v. *Commissioner,* 135 F. 2d 310, 313 (C. A. 2); *Philadelphia Park Amusement Co.* v. *United States,* 130 Ct. Cl. 166. But a payment on account of an item of expense, which item is indeterminate in amount at the close of the taxable year, is incapable of such realization even though it constitutes ordinary and necessary business expense. *Burnet* v. *Logan,* 283 U. S. 404, 413. Here the court, at the Government's urging, refused to consider evidence which showed that the contributions were in fact payments on account (pet. 5-9).

In the same vein, the Government argues (br. 3):

> "Like the payment of bonuses and salaries, the stock transfers reduced the risk of losing employees to higher paying competitors and were a means of preventing labor disputes. Since petitioner's disposition of the securities resulted in an economic benefit to it, they were taxable events."

Thus the Government would gloss over the distinction between contributions to a fixed benefit self-administered plan and the plan itself. Accepting the Government's position, the court, as shown above, held irrelevant the record facts which showed that the employer advantages deriving from the plan in a given year are in no way related to the employer's contribution or failure to contribute in that year, but were received by the employer in consideration of the employees' expectation that retirement pensions would be paid in full (pet. 5-9). Thus again, in opposition to this application the Government is stating as an unsupported conclusion the reverse of what is shown by undisputed evidence which the Government persuaded the court below to refuse to consider.

2. *United States* v. *Davis*, 370 U. S. 65, relied on by the Government, is clearly distinguishable from the case at bar. In *Davis* in exchange for appreciated securities a husband received consideration in a closed transaction, i.e., "his ex-wife's release of her marital rights . . ." (br. 3). Petitioner concedes that where, as there, appreciated property with a market value is transferred by the taxpayer in a closed transaction in exchange for property without market value, the

value of the first mentioned property may be attributed to the second mentioned property, and the appreciation in the first mentioned property thereby realized. In the case at bar, on the contrary, there was no closed transaction in either taxable year.

3. As a prop for the decision below, the Government urges further (br. 3-4) "that petitioner would have been liable for the capital gain tax here in controversy, if, instead of transferring the stock to the pension trust in kind, it had sold the stock and transferred the proceeds to the trustee." Both the facts and the law show the fallacy of this claim. If petitioner had sold the securities, its venture in them would have been ended and they would have been converted into $125,000 toward pension payments (R. 344). Under the transaction which in fact occurred, the end of the taxable year of each contribution found it undetermined how much the contributed securities would, when sold, produce toward pension costs over and above the $36,000 which the securities had cost (R. 344). To be sure, petitioner was not legally bound to see pensions paid (R. 345), but could fail to do so only at the risk of losing its labor force and being put out of business (R. 343, 211, 217). Even if this were not so—even if, on the contrary, the economic effect on petitioner of contributing in kind had been identical with the effect of sale and contribution of the proceeds, it is well settled that a taxpayer may not be taxed on the transaction which it chose not to make, and in fact did not make, whether or not the choice was made with an eye to minimizing its taxes. *Bullen* v. *Wisconsin*, 240 U. S. 625, 630; *Lewyt Corp.* v. *Commissioner*, 349 U. S. 237, 240; *United States* v. *Cumberland Public Service Co.*,

338 U. S. 451, 455-6; *Hanover Bank* v. *Commissioner*, 369 U. S. 672, 687-8.

4. The Government's attempt (br. 4) to show that no conflict obtains between the decision below and *Lincoln Electric Co.* v. *Commissioner*, 162 F. 2d 379 (C. C. A. 6), is clearly unavailing. *Lincoln Electric* stands for the proposition that a pension plan contribution need not constitute compensation to be deductible (162 F. 2d pp. 380, 382, 385), while the court below held the other way in the case at bar (R. 339-40).

5. Likewise unavailing is the Government's attempt (br. 5) to explain away the error below in failing to give effect to the rule that neither gain nor loss may be taken into account for tax purposes until the sale, exchange or conversion on which it is alleged to have been realized is completed and closed. Although in *Burnet* v. *Logan, supra*, it was expected that the taxpayer would receive, in the transaction in question, further payments in later years, the rule is not limited to such a state of facts. It applies equally where, as here, the taxpayer remains under continuing liability. Rev. Rul. 59-47, 1959-1 C. B. 198. Furthermore the facts deemed irrelevant by the court below show that a self-administered fixed benefit pension plan is in fact a continuing flow from the institution of the plan until its termination, not a series of annual segments; and this is so from the standpoint of employee benefits, employer advantage, cost, and cost deduction. The correlation between this long-range effort at social engineering and the income tax system based on annual rests and accountability for annual periods is based on a program of tax incentives offered by Congress as a matter of long standing policy to bring about the estab-

lishment and current funding of "qualified" private retirement systems (pet. 13-16). Among those incentives are the right to deduct contributions annually, estimated as a level premium from entry into the plan to retirement, *e.g.* § 404(a)(1)(B), I. R. C.; and another is the right to deduct a contribution in property at market value. *Colorado National Bank of Denver*, 30 T. C. 933, acq. 1959-1 C. B. 3.

The petition should be granted as prayed.

Respectfully submitted,

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